

REPORT OF EXAMINATION
OF THE
FREMONT INDUSTRIAL INDEMNITY COMPANY
AS OF
DECEMBER 31, 1999

Participating States
and Zones:

California
Delaware, Zone I-Northeastern

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Los Angeles, California
May 31, 2001

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Bob Lohr
Secretary, Zone IV-Western
Director of Insurance
Alaska Department of Insurance
Anchorage, Alaska

Honorable Donna Lee Williams
Secretary, Zone I-Northeastern
Commissioner of Insurance
Delaware Insurance Department
Dover, Delaware

Honorable Harry W. Low
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Commissioners and Director:

Pursuant to your instructions, an examination was made of the

FREMONT INDUSTRIAL INDEMNITY COMPANY
(formerly Industrial Indemnity Company)

(hereinafter also referred to as the Company) at the primary location of its books and records, 500 North Brand Boulevard, Glendale, California 91203.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1993. This examination covers the period from January 1, 1994 through December 31, 1999. An examiner from Delaware, representing the Zone I - Northeastern of the National Association of Insurance Commissioners, participated in the examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 1999, as deemed necessary under the circumstances. The original examination date was December 31, 1998, but due

to significant examination findings with regard to the Company's financial condition, the examination was updated to December 31, 1999. The updated examination included (1) a complete actuarial analysis of the Company's loss and loss adjustment expense reserves, (2) a review and update of the Company's invested assets, and (3) an update of the Company's reinsurance program and related accounts.

The examination of the Company was made concurrently with the following examinations of the Company's affiliates within the Fremont Compensation Insurance Group, Inc.: Fremont Indemnity Company, Fremont Compensation Insurance Company, Fremont Employers Insurance Company, Fremont Pacific Insurance Company and Comstock Insurance Company (a discontinued operation).

In addition Fremont Casualty Insurance Company is currently undergoing an examination by the Illinois Department of Insurance.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

SUMMARY OF SIGNIFICANT FINDINGS

As a result of this examination, surplus as regards policyholders as of December 31, 1999 has been reduced by \$151.1 million to a deficit of \$(9.4) million. The reduction in surplus was primarily due to increases in the Company's losses and loss adjustment expense reserves.

The Company entered into a Letter Agreement (Agreement) with the California Department of Insurance (CDI) on November 27, 2000. As part of the Agreement, the CDI will appoint a Special Deputy Examiner to provide supervision and regulatory oversight of the Company on behalf of the

California Insurance Commissioner. The Agreement is made part of this Examination Report as an Addendum (see “Addendum – Letter Agreement of Regulatory Oversight”)

In addition to the Agreement, on November 27, 2000 the CDI granted a permitted accounting practice to the Fremont Compensation Insurance Group (Fremont Indemnity Company, Fremont Industrial Indemnity Company, Fremont Compensation Insurance Company, Fremont Pacific Insurance Company, Fremont Employers Insurance Company, Fremont Casualty Insurance Company, and Fremont Indemnity Company of the Northwest) to discount its workers’ compensation loss and allocated loss adjustment expense reserves for accident years 1999 and prior. The effective date of this permitted accounting practice is September 30, 2000. The discount rate is 4.25% and is to be applied on loss and allocated loss adjustment expense reserves identified as the mid-point reserves in the Company’s Certified Public Accounting firm’s Actuarial Analysis Report as of June 30, 2000.

Due to the timing of the granting of the permitted practice, and for purposes of the September 30, 2000 Quarterly Financial Statement filing, each member company of the Fremont Compensation Insurance Group reflected its proportionate discount in its own filed statutory Quarterly Financial Statements. This permitted accounting practice was accounted for by reflecting the loss reserve discount as a contra-liability in the balance sheet, and as a direct increase to surplus (segregated surplus).

Under a separate letter dated December 29, 2000, the CDI granted the Fremont Compensation Insurance Group a permitted accounting practice to discount its worker’s compensation loss and allocated loss adjustment expense reserves for accident years 1999 and prior in the same manner described above for the year ending December 31, 2000, and the Quarterly Financial Statements for the first three quarters of the year 2001.

Since these permitted accounting practices are only effective as of September 30, 2000, December 31, 2000 and the first three quarters of 2001, a request for similar accounting treatment must be

made for any subsequent year-end periods. In reviewing such a request, the CDI will consider the appropriateness of the discount rate in light of the actual yield on supporting assets, and actual development of incurred losses and loss adjustment expenses.

After applying the provisions of the permitted accounting practice and including all other examination adjustments, the Company reported surplus as regards policyholders of \$97.9 million as of September 30, 2000.

For purposes of the December 31, 2000 Annual Statement, and Quarterly Statement filings thereafter, it is contemplated that the entirety of the discount related to accident years 1999 and prior will be reported in only one company (Fremont Pacific Insurance Company) and identified as discontinued operations. The purpose of this is to have all of the discounted reserves, which were permitted by the CDI, accounted for in one company.

The Company's ultimate parent, Fremont General Corporation, has also committed to infuse additional capital into the Fremont Compensation Insurance Group of \$6 million per year, for the next five years. In addition, the Company began a significant re-pricing and re-underwriting of its book of business and has significantly reduced its general overhead expenses.

SUBSEQUENT EVENTS

Significant events subsequent to the examination date through May, 2001 include the following:

- (1) On October 30, 2000, the Company entered into a claims servicing agreement with Cambridge Integrated Services Group, Inc. The outsourcing of certain claims adjusting services provided the Company with the ability to close certain offices to obtain expense reductions. The agreement was amended three times subsequently to include additional office closures in December 2000 and April and May 2001.
- (2) In December 2000, A.M. Best downgraded the financial strength rating of the Company from a B (fair) to E (under regulatory supervision).

- (3) On December 14, 2000 the Fremont Compensation Insurance Group (Fremont Group) announced the closing of 16 of the 24 production and claims services offices. This action was a continuation of efforts by the Company and its affiliates, which began in the third quarter of 2000 to cut operating expenses to levels considered appropriate for expected reduction in premium writings. This action has also resulted in further workforce reductions.
- (4) Pursuant to California Insurance Code (CIC) Section 1011(c), the Company and its affiliates obtained approval from the California Department of Insurance (CDI) on December 28, 2000 to enter into quota share and loss portfolio reinsurance agreements.

Under the terms of the quota share reinsurance agreement to be entered into between Fremont Indemnity Company (FIC) and Fremont Pacific Insurance Company (FPIC) effective October 31, 2000, FPIC will cede to FIC all liability for loss and allocated loss adjustment expenses under all of FPIC's policies, contracts, binders of insurance and reinsurance in force on the effective date of the agreement.

Pursuant to the terms of a loss portfolio reinsurance agreement effective October 31, 2000, the Company and Fremont Compensation Insurance Company (FCIC), Fremont Casualty Insurance Company (FCAS) and Fremont Indemnity Company (FIC) will each cede to FPIC all of each insurers' respective liabilities for loss and allocated loss adjustment expenses under all of each insurers' non-workers' compensation insurance policies, contracts and binders. In addition, all workers' compensation liabilities for loss and allocated loss adjustment expenses for the 1999 and prior accident years will be ceded to FPIC.

Subject to CDI approval of these reinsurance agreements, FPIC will not write any new business and would exist solely for the purpose of running off all the non-worker's compensation reserves and the 1999 and prior accident year workers' compensation reserves. FPIC will no longer be a participant in the Intercompany Pooling Agreement.

In addition to and in conjunction with the above reinsurance agreements, the reinsurance pooling agreement will be amended (eighth) to reflect the remaining pool participants and the new pool percentages as follows: FIC-73%, FCAS-15%, FIIC-7% and FCIC-5%.

With respect to the quota share and loss portfolio reinsurance agreements and the amendment (eighth) to the Intercompany Pooling Agreement, the CDI granted a permitted accounting practice to effect the asset transfers under these agreements at statement value.

In addition, to the extent that the single insurer investment limitations of the CIC are exceeded by any of the Fremont Group companies as a result of the reduction in surplus as a consequence of reserve strengthening and the realignment of surplus and invested assets pursuant to these

agreements, the CDI granted a permitted accounting practice to hold as admitted assets, until sale or maturity, those portions of any such assets that exceed the single issuer investment limitations of the CIC. Any new (subsequent to December 31, 2000) purchases of notes or securities are not subject to this exemption. This permitted accounting practice is only effective as of December 31, 2000 and for the three subsequent quarters of year 2001. The permitted practices letter issued by the CDI requires the Company to reduce its investment holdings that exceed the investment limitations of the CIC. A request for similar accounting treatment must be made for any years subsequent to December 31, 2000.

- (5) Effective May 1, 2001, the Company and its affiliates entered into several agreements with Clarendon Insurance Group, Inc. to provide a fronting program whereby the Company has the ability to offer its new and renewal policies with an “A” rated carrier. The program is limited to \$200 million of premium volume from May 1, 2000 through May 31, 2002. The program provides for a guaranteed fronting fee of \$13 million (6.5% times \$200 million premium). The Company’s ultimate parent, Fremont General Corporation, has issued a guarantee of the fronting fee.

The program is on a funds withheld basis. The initial combined ratio assumed by the program is 117.9%. The Company is required to provide two forms of collateral. One form will be the premiums, which will be deposited into a funds withheld account and will provide collateral up to 100%. The second form of collateral is a trust account wherein the Company is required to deposit funds in advance on a quarterly basis equal to the additional 17.9% of the combined ratio.

COMPANY HISTORY

The Company is a wholly-owned subsidiary of Fremont Indemnity Company (FIC). FIC is owned by Fremont Compensation Insurance Group, Inc. (FCIG) which, in turn, is a wholly-owned subsidiary of Fremont General Corporation (FGC). The Company has the following seven wholly-owned insurance subsidiaries: Fremont Compensation Insurance Company, (FCIC), Fremont Pacific Insurance Company (FPIC), Fremont Indemnity Company of the Northwest (FICNW), Fremont Employers Insurance Company (FEIC), Fremont Casualty Insurance Company (FCAS), Fremont Reinsurance Company, Ltd. and Menlo Life Insurance Company (Menlo).

FIC also has two insurance company affiliates, Fremont Life Insurance Company (FLIC) and Comstock Insurance Company (Comstock), which discontinued its operations in 1986. Comstock

now includes the discontinued operations of Fremont Reinsurance Company, which was merged into Comstock in 1998.

Mergers and Acquisitions

During the period covered by this examination, the Company and its affiliates have been a party to several significant mergers and acquisitions as follows:

- (1) On February 22, 1995, FCIC purchased 100% of the issued and outstanding stock of Casualty Insurance Company (CIC), an Illinois domiciled insurance company, and its subsidiary, Workers' Compensation and Indemnity Company of California (WCIC), a California domiciled insurance company, for \$250 million.
- (2) On June 30, 1996, the California and Illinois Departments of Insurance approved a dividend of the common stock of WCIC valued at its statutory surplus of \$7.2 million from CIC to FCIC. FCIC then declared a dividend of WCIC to Fremont Pacific Insurance Group, Inc. (FPIG), which in turn declared a dividend of WCIC to FIC. FIC then declared a dividend of WCIC to FCIG. On December 31, 1997 WCIC was merged into FIC.
- (3) On June 30, 1997, FIC purchased all of the issued and outstanding shares of Citation National Insurance Company (CNIC) for \$5.5 million. Effective December 31, 1997, CNIC was merged into FIC.
- (4) On August 1, 1997, FIC purchased all of the issued and outstanding shares of Industrial Indemnity Holdings, Inc. (IIH) for \$355 million. IIH was the parent of the following insurance companies: Industrial Indemnity Company of Alaska (IIAK), Industrial Indemnity Company of Idaho (IIID), Industrial Indemnity Company of the Northwest (IINW), Employers First Insurance Company (EFI) and Industrial Insurance Company (IINS) and the Company. On December 31, 1997, IIH declared dividends of its insurance subsidiaries to FIC. IIH was then merged into Fremont Compensation Insurance Group, Inc. and IINS was merged into FIC.
- (5) On September 1, 1998, FIC acquired Unicare Specialty Services, Inc. (USSI) for \$110 million and on September 21, 1998 USSI dividended the stock of its subsidiary, Unicare Workers' Compensation Insurance Company (UWCIC) (formerly Unicare Insurance Company) to FIC. On October 22, 1998, FIC dividended the stock of USSI to Fremont Compensation Insurance Group, Inc. (FCIG). On December 11, 1998, USSI was merged into FCIG.

- (6) On December 31, 1998, FCIC dividdened CIC and FPIC to FIC; FPIC dividdened its subsidiary, Fremont American Insurance Company (FAIC) to FIC; FCIC was merged into UWCIC; FAIC was merged into FIC; IIAK and IIID were merged into the Company, and UWCIC was renamed Fremont Compensation Insurance Company.
- (7) On May 1, 1999, FIC purchased 100% of the issued and outstanding shares of Menlo Life Insurance Company (Menlo) for \$2.9 million from Fremont Life Insurance Company.

The respective company's domiciliary State Department of Insurance approved all of the above transactions.

(All references to Fremont Compensation Insurance Company (FCIC) prior to December 1998 refer to the former Fremont Compensation Insurance Company which was merged into UWCIC in December 1998.)

As a result of the previously mentioned mergers or acquisitions, the following California insurance companies ceased to exist: Workers' Compensation and Indemnity Company of California (WCIC), Citation National Insurance Company (CNIC), Industrial Insurance Company (IIC) and Fremont American Insurance Company (FAIC).

The following is a summary of the acquisition and merger activity and name changes of the FCIG insurance companies during the examination period:

Company's Former Name(s)	Acquisition/ Merger	Company's Current Name
Fremont Indemnity Company		Fremont Indemnity Company
Industrial Indemnity Company	Acquired in 1997	Fremont Industrial Indemnity Company
Industrial Indemnity Company of the Northwest	Acquired in 1997	Fremont Indemnity Company of the Northwest
All West Insurance Company and Employers First Insurance Company	Acquired in 1997	Fremont Employers Insurance Company
Unicare Insurance Company and Unicare Workers' Compensation Insurance Company	Acquired in 1998	Fremont Compensation Insurance Company

Company's Former Name(s)	Acquisition/ Merger	Company's Current Name
Pacific Compensation Insurance Company		Fremont Pacific Insurance Company
Casualty Insurance Company	Acquired in 1995	Fremont Casualty Insurance Company (Illinois)
Fremont Reinsurance Company, Ltd. (Bermuda)		Fremont Reinsurance Company, Ltd. (Bermuda)
Comstock Insurance Company		Comstock Insurance Company (discontinued operations)
Fremont Insurance Company (UK), Ltd.		Fremont Insurance Company (UK), Ltd. (discontinued operations)
Workers' Compensation and Indemnity Company of California	Acquired in 1995 and merged into Fremont Indemnity Company in 1997	
Fremont Reinsurance Company	Merged into Comstock Insurance Company in 1998	
Beaver Insurance Company and Fremont American Insurance Company	Merged into Fremont Indemnity Company in 1998	
Industrial Indemnity Company of Idaho	Acquired in 1997 and merged into Fremont Industrial Indemnity Company in 1998	
Industrial Indemnity Company of Alaska	Acquired in 1997 and merged into Fremont Industrial Indemnity Company in 1998	
Citation National Insurance Company	Acquired and merged into Fremont Indemnity Company in 1997	
Industrial Insurance Company	Acquired in 1997 and merged into Fremont Indemnity Company in 1997	
Fremont Compensation Insurance Company	Merged into Unicare Workers Compensation Insurance Company in 1998	
Menlo Life Insurance Company	Acquired in 1999	Menlo Life Insurance Company

As of December 31, 1999, the Fremont Compensation Insurance Group (FCIG) insurance companies currently had applications pending approval with the California and Washington Departments of Insurance to merge Fremont Employers Insurance Company (FEIC) into the Fremont Indemnity Company and Fremont Indemnity Company of the Northwest (FICNW) into the Company . The Company also is seeking approval to dividend all of its outstanding shares of Fremont Pacific Insurance Company (FPIC) to its immediate parent company, Fremont Compensation Insurance Group, Inc.

Gross Paid-in and Contributed Surplus and Unassigned Funds

The Company and its affiliates that are a part of the Intercompany Pooling Agreement engaged in certain securities transactions (at book value) among affiliates to reallocate surplus among the companies pursuant to the pooling agreement. During the period covered by this examination, the Company's surplus as regards policyholders decreased \$161 million due to the realignment of assets (and the corresponding decrease in surplus).

Although the transfer of assets and corresponding surplus at book value was approved by the California Department of Insurance (CDI) in 1998, the request for approval by the Company and the approval by the CDI were silent with regard to how to account for the surplus adjustments. The Company accounted for the surplus adjustments via increases and decreases to the unassigned funds and gross paid-in and contributed surplus accounts of the companies included in the reinsurance pool. Under Statutory Accounting Principles, surplus adjustments resulting from a Intercompany Pooling Agreement should only affect unassigned funds. Gross paid-in and contributed surplus would remain unchanged. The Company's accounting for the Intercompany Pooling Agreement resulted in a reallocation of surplus among the companies participating in the pool and a further reallocation between gross paid-in and contributed surplus and unassigned funds.

In addition to the realignment and reallocation of surplus under the Intercompany Pooling Agreement, the Company also accounted for mergers by reallocating gross paid-in and contributed surplus and unassigned funds. Although there was no statutory guidance for accounting for mergers at the time the Company entered into these transactions, Generally Accepted Accounting Principles (under the pooling of interest method) requires that assets, liabilities and capital accounts of merged companies be transferred to the surviving company exactly as they were accounted for in the merged company.

As noted in the following schedule, the reallocation and distribution of surplus accounts between gross paid-in and contributed surplus and unassigned funds due to the Intercompany Pooling Agreement and the mergers during the examination period resulted in significant changes to the distribution of the Company's surplus:

Description of Transaction	Year Ending	Per Company		Examination Reclassification	Per Examination Reclassification*	
		Gross Paid-in and Contributed Surplus	Unassigned Funds	to Unassigned Funds and Gross Paid-in and Contributed Surplus	Gross Paid-in and Contributed Surplus	Unassigned Funds
	1993	\$ 197,000,042	\$ 91,887,037		\$ 197,000,042	\$ 91,887,037
	1994	\$ 197,000,042	\$ 104,287,009		\$ 197,000,042	\$ 104,287,009
	1995	\$ 197,000,042	\$ 97,412,784		\$ 197,000,042	\$ 97,412,784
	1996	\$ 197,000,042	\$ 17,316,699		\$ 197,000,042	\$ 17,316,699
1997 Alignment for Repooling		(88,246,570)		(88,246,570)		
	1997	\$ 108,753,472	\$ (2,309,882)	\$ (88,246,570)	\$ 197,000,042	\$ (90,556,452)
Merger of IIAK				(3,900,000)	(3,900,000)	
Merger of IIID				(1,650,500)	(1,650,500)	
	1998	\$ 108,753,472	\$ 46,569,232	\$ (93,797,070)	\$ 202,550,542	\$ (47,227,838)
	1999	\$ 108,753,472	\$ 28,663,723	\$ (93,797,070)	\$ 202,550,542	\$ (65,133,347)

* exclusive of all other examination changes

For purposes of this examination report, gross paid-in and contributed surplus and unassigned funds were restated to correctly account for the Intercompany Pooling Agreement and the mergers. It is recommended that the Company reclassify unassigned funds and gross paid-in and contributed surplus as indicated in the examination report (see also Comments on Financial Statement Items Note (8)) and account for all future similar transactions in accordance with Statutory Accounting Principles.

Dividends to Stockholders

The following is a summary of dividends paid by the Company to its parent during the period covered by the examination as compared to its unassigned funds as reported by the Company and

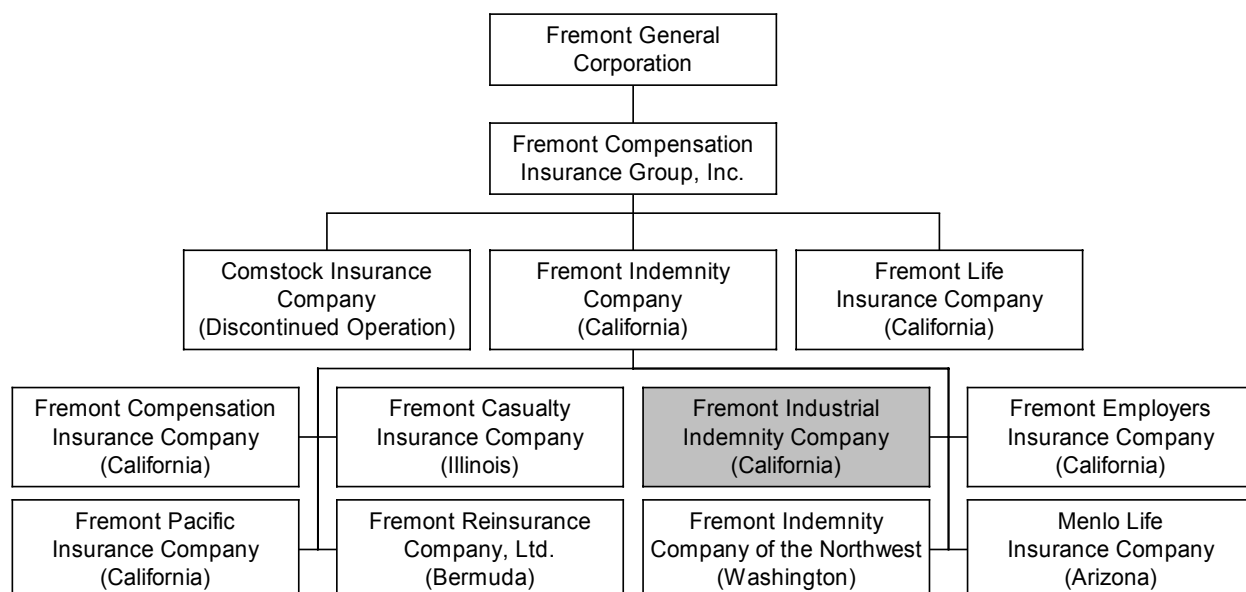
Year	Unassigned Funds		Dividends Paid
	Per Company	Per Reclassification*	
1994	\$ 104,287,009	\$ 104,287,009	\$ 28,278,738
1995	\$ 97,412,784	\$ 97,412,784	\$ 34,900,000
1996	\$ 17,316,699	\$ 17,316,699	\$ 85,950,000
1997	\$ (2,309,882)	\$ (90,556,452)	\$ 10,321,000
1998	\$ 46,569,232	\$ (47,227,838)	\$ 558,000
1999	\$ 28,663,723	\$ (65,133,347)	\$ 10,764,750

* exclusive of all other examination changes as reclassified by this examination.

The schedule indicates that dividends paid by the Company for several of the years under examination (after examination reclassifications) were paid out of negative assigned funds (earned surplus). California Insurance Code Section 1152(a) stipulates that dividends may only be paid out of earned surplus.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Fremont General Corporation (FGC) is the ultimate controlling entity. FGC is a diversified holding company, engaged in insurance and financial service businesses through its subsidiaries. An abridged organization chart depicting the Company's relative position within the holding company system follows:



Management of the Company is vested in a seven-member board of directors. Following are lists of directors and the principal officers of the Company as of December 31, 1999:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
James A. McIntyre Los Angeles	Chairman of the Board Fremont General Corporation
Wayne R. Bailey Calabasas, California	Vice President and Treasurer Fremont General Corporation
John A. Donaldson Los Angeles, California	Vice President Fremont General Corporation
Ronald A. Groden (1) Los Angeles, California	Executive Vice President and Chief Financial Officer Fremont Compensation Insurance Group, Inc.
Raymond G. Meyers Agoura, California	Vice President Fremont General Corporation
W. Brian O'Hara (*) (2) Los Angeles, California	Executive Vice President Fremont Compensation Insurance Group, Inc.
Louis J. Rampino Long Beach, California	President and Chief Executive Officer Fremont General Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Louis J. Rampino	President and Chief Executive Officer
Ronald A. Groden (1)	Executive Vice President and Chief Financial Officer
W. Brian O'Hara (*) (2)	Executive Vice President
Allyson B. Simpson (3)	Senior Vice President and Secretary
Daniel G. Platt (2)	Senior Vice President and Controller

Name

Title

Wayne R. Bailey

Vice President and Treasurer

(1) Resigned in January 2001

(2) Resigned in May 2001

(3) Terminated in April 2001

(*) appointed President and Chief Executive Officer of the Company in 2000

Management Agreements

Services and Investment Management Agreement: The Company and all of its insurance affiliates are parties to a Services and Investment Management Agreement with the ultimate parent, Fremont General Corporation (FGC). FGC provides investment management and administrative services. The Company and its affiliates reimburse FGC for the actual cost of these services.

For 1997, 1998 and 1999, the Company paid \$2,334,067, \$1,493,347 and \$1,355,475 respectively, in fees to FGC under the terms of this agreement

Tax Sharing Agreement: The Company and the other members of the reinsurance pool (insurance companies) are parties to a Tax Sharing Agreement with FGC. Allocation of federal income taxes is based on separate return calculations. Any differences between the sum of the separate return tax liabilities, the separate return tax refunds, and the consolidated federal income tax liability is to be paid or retained by FGC at its discretion.

The insurance companies are only to be paid a recoverable from FGC if it also has a consolidated loss, and then the recoverable is at the discretion of FGC. Ultimately, any benefit gained by the insurance companies that have arisen out of income tax losses is up to the discretion of FGC management.

Based on discussions with Company management, none of the insurance companies have ever received a direct tax benefit of net operating losses (NOLs). Although the amounts may be material, the monetary impact of the implementation of this agreement is not readily determinable as it would require a review of the actual tax returns of each insurance company participating in the agreement over the years it has been in force.

Based on the terms and implementation of this agreement, it does not appear to be fair and reasonable to the insurance companies. Therefore, this agreement appears to be in violation of California Insurance Code Section 1215.5(a)(1), which states, in part, that the terms of transactions between affiliates should be fair and reasonable. It is recommended that the Company amend the terms of the tax sharing agreement so that its tax position, after consolidation, is not inferior to what it would have been had it filed on a stand-alone basis.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report draft and the final filed report and enter that fact in the board minutes. A review of the board minutes disclosed that neither the draft nor the final report was submitted to the board of directors. It is recommended that the Company comply with CIC Section 735.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact insurance in the District of Columbia and all states, except West Virginia.

In 1999, the Company wrote approximately \$313 million of direct premiums, (28%) in California, (10%) in New Jersey, (10%) in Arizona with the remainder in various other states. Of the direct

premiums written by the Company in 1999, 99% pertained to workers' compensation with the remainder being other liability business.

REINSURANCE

Intercompany Pooling Agreement

The Company is party to a Intercompany Pooling Agreement with its affiliates. The pool participants cede substantially all of their direct and assumed business net of unaffiliated reinsurance to the pool. Lines of business subject to pooling are workers' compensation and medical malpractice. The following is a schedule of the pool participants and the pooling percentages as of December 31, 1999:

Pool Participant	% of Participation
Fremont Indemnity Company (FIC)	39.50%
Fremont Casualty Insurance Company (FCAS)	24.00%
Fremont Industrial Indemnity Company (FIIC)	23.25%
Fremont Compensation Insurance Company (FCIC)	10.00%
Fremont Pacific Insurance Company (FPIC)	1.50%
Fremont Indemnity Company of the Northwest (FICNW)	1.25%
Fremont Employers Insurance Company (FEIC)	<u>.50%</u>
Total	<u>100.00%</u>

Assumed

In addition to the Intercompany Pooling Agreement, the following is a summary of the principal assumed reinsurance from affiliates, inforce or in runoff:

- (1) Under the terms of a 100% quota share reinsurance agreement effective January 1, 1991, FCIC and FPIC assume workers' compensation business from FIC. The business is produced by each assuming participant company in states other than California and written (under a fronting arrangement) by FIC on each company's behalf.

- (2) Effective July 1, 1990, FIC entered into a credit disability reinsurance treaty with its affiliate, Fremont Life Insurance Company (FLIC). Under the terms of this agreement, FIC assumed 100% of the credit disability insurance written by FLIC from January 1, 1985 through 1994. This agreement is now in runoff.
- (3) On December 31, 1994, FIC and an affiliate, Comstock Insurance Company (Comstock), entered into a portfolio reinsurance agreement. Under the terms of the agreement, FIC assumed all liabilities and obligations of Comstock on business classified as workers' compensation and other liabilities.

Ceded

The following is a summary of the reinsurance in force as of December 31, 1999 covering workers' compensation business for all companies in the Fremont Compensation Insurance Group:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
1 st Excess of Loss	Constitution Reinsurance Corporation	\$50,000 each loss occurrence	\$50,000 each loss occurrence
2 nd Excess of Loss	Reliance Insurance Company	\$100,000 each loss occurrence	\$150,000 each loss occurrence
3 rd Excess of Loss	TIG Reinsurance Company – 50% Zurich Reinsurance Centre, Inc. – 50%	\$250,000 each loss occurrence	\$750,000 each loss occurrence
Per Person Excess of Loss	Various Reinsurers	\$1 million per person	\$19 million per person
Per Occurrence Excess of Loss	Various Reinsurers	\$1 million each loss occurrence	\$400 million each loss occurrence

In addition, the following are the principal reinsurance agreements in force or in cutoff not common to all companies in the Fremont Compensation Insurance Group as of December 31, 1999:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Excess of Loss	The Fire and Casualty Insurance Company of Connecticut	\$25,000 each loss occurrence	\$475,000 each loss occurrence

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Quota Share	Zurich Reinsurance Centre, Inc. - 60% Hartford Fire Insurance Co. - 20% Underwriters Reinsurance Co. - 20%	None	100% of net retained liability not to exceed 5% of total premium per state ceded.
Aggregate Excess Stop Loss (for 1985 and prior accident years)	Employers Insurance of Wausau	None	Not to exceed \$25 million in aggregate liability
Aggregate Excess Stop Loss (for 1986 and 1987 accident years)	Employers Insurance of Wausau	None	Not to exceed \$17.5 million in aggregate liability
Aggregate Excess (for 1989 and prior accident years)	Employers Insurance of Wausau	None	100% of \$6 million and 70% thereafter
Aggregate Excess of Loss	The Continental Insurance Company	None	\$56 million
Aggregate Stop Loss	The Continental Insurance Company	None	\$8 million excess of the aggregate

Unicover Pool

The Company ceded a portion of its workers' compensation business to Reliance Insurance Company (Reliance) under the terms of an excess of loss reinsurance treaty (effective January 1, 1998 through December 31, 1999). Reliance entered into reinsurance fronting arrangements as part of a workers' compensation insurance facility created and managed by Unicover Managers, Inc. (Unicover). Under these arrangements, Reliance retroceded 100% of the occupational accident and health portion of the workers' compensation business. As of December 31, 1999, the Company and its affiliated members of the reinsurance pool (the Fremont Group) ceded the following combined amounts to Reliance under the terms of the reinsurance treaty:

(\$000 omitted)	
Description	Amount

Ceded Premiums (net of ceding commissions)	\$126,264
Reserve Credits Taken	\$190,711(*)
Loss and LAE Payments	\$ 10,553

(*) does not reflect additional loss reserves and loss adjustment reserves established by the examination

On February 28, 2000, the Fremont Group reached an agreement with Reliance to rescind this reinsurance treaty. The retroactive effect to the Fremont Group of rescinding this treaty as of December 31, 1999 was an increase to losses and loss adjustment expense reserves of \$191 million and an increase to amounts due from reinsurer of \$116 million. The net effect, to the Company, after applying its pooling percentage of 23.25%, was to decrease its surplus by \$17.4 million. Although the recession of this treaty was included in the GAAP consolidated financial statements of Fremont General Corporation, it was not reflected in the Company's year-end 1999 Annual Statement. The financial statements included in this examination report include the rescission.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 1999

Underwriting and Investment Exhibit for the year Ended December 31, 1999

Reconciliation of Surplus as Regards Policyholders
from December 31, 1993 through December 31, 1999

Reconciliation of Examination Changes as of December 31, 1999

Statement Financial Condition
as of December 31, 1999

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 323,937,039	\$	\$ 323,937,039	(1)
Stocks:				
Preferred stocks	115,421,169		115,421,169	(1)
Common	60,000		60,000	
Real estate:				
Properties occupied by the company	3,328,584		3,328,584	
Cash and short-term investments	41,988,460		41,988,460	
Other invested assets	36,495		36,495	(2)
Receivable for securities	14,657		14,657	
Premiums and agents' balances in course of collection	(7,586,851)	2,331,023	(9,917,874)	
Premiums, agents' balances and installments booked but deferred and not yet due	31,574,409	717,545	30,856,864	
Accrued retrospective premiums	8,839,773	883,977	7,955,796	
Reinsurance recoverable on loss and loss adjustment expense payments	6,822,512		6,822,512	
Federal income tax recoverable and interest thereon	20,728,817	20,728,817	0	(3)
Electronic data processing equipment	2,309,193	2,053,594	255,599	(4)
Interest, dividends and real estate income due and accrued	6,901,157		6,901,157	
Equities and deposits in pools and associations	388,749		388,749	
Other assets nonadmitted	6,255,804	6,255,804	0	
Aggregate write-ins for other than invested assets	42,277,235	1,493,094	40,784,141	(5)
Total assets	<u>\$ 603,297,202</u>	<u>\$ 34,463,854</u>	<u>\$ 568,833,348</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 491,380,353	(6)
Other expenses			10,694,043	
Taxes, licenses and fees			4,583,646	
Unearned premiums			49,811,342	
Funds held by company under reinsurance treaties			54,640	
Provision for reinsurance			677,950	
Excess of statutory reserves over statement reserves			481,740	
Drafts outstanding			1,882,205	
Payable to parent, subsidiaries and affiliates			827,777	
Aggregate write-ins for liabilities			<u>17,876,207</u>	(7)
Total liabilities			578,269,903	
Common capital stock		\$ 4,200,000		
Gross paid-in and contributed surplus		202,550,512		(8)
Unassigned funds (surplus)		<u>(216,187,067)</u>		(8)
Surplus as regards policyholders			<u>(9,436,555)</u>	
Total liabilities, surplus and other funds			<u>\$ 568,833,348</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 1999

Statement of Income

Underwriting Income

Premiums earned		\$ 193,015,142
Deductions:		
Losses and loss expenses incurred	\$ 315,433,657	
Other underwriting expenses incurred	<u>64,963,086</u>	
Total underwriting deductions		<u>380,396,743</u>
Net underwriting loss		(187,381,601)

Investment Income

Net investment income earned	35,357,868	
Net realized capital losses	<u>(5,911,986)</u>	
Net investment gain		29,445,882

Other Income

Net loss from agents' balances charged off	\$ (474,613)	
Finance and service charges not included in premiums	2,016	
Aggregate write-ins for miscellaneous income	<u>784,198</u>	
Total other income		<u>311,601</u>
Net loss before dividends to policyholders and before federal and foreign income taxes		(157,624,118)
Dividends to policyholders		6,278,397
Federal and foreign income taxes incurred		<u>(12,611,707)</u>
Net loss		<u>\$ (151,290,808)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1998		\$ 159,522,704
Net loss	\$ (151,290,808)	
Net unrealized capital losses	(17,270,193)	
Change in nonadmitted assets	10,243,578	
Change in provision for reinsurance	604,654	
Change in excess of statutory reserves over statement reserves	(481,740)	
Dividends to stockholders	<u>(10,764,750)</u>	
Change in surplus as regards policyholders for the year		<u>(168,959,259)</u>
Surplus as regards policyholders, December 31, 1999		<u>\$ (9,436,555)</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 1993 through December 31, 1999

Surplus as regards policyholders, December 31, 1993, per Examination			\$ 263,340,980
	<u>Gain in</u> <u>Surplus</u>	<u>Loss in</u> <u>Surplus</u>	
Net income	\$ 11,354,848	\$	
Net unrealized capital losses		3,684,654	
Change in nonadmitted assets	34,911,633		
Change in provision for reinsurance	2,352,037		
Change in excess of statutory reserves over statement reserves		180,740	
Transferred from surplus (Stock Dividend)	1,200,000		
Transferred to capital (Stock Dividend)		1,200,000	
Dividends to stockholders (cash)		171,123,488	
Surplus of merged companies	10,115,776		
Aggregate write-ins for losses in surplus		<u>156,522,947</u>	
Total gains and losses in surplus	<u>\$ 59,934,294</u>	<u>\$ 332,711,829</u>	
Decrease in surplus as regards policyholders			<u>(272,777,535)</u>
Surplus as regards policyholders, December 31, 1999, per Examination			<u>\$ (9,436,555)</u>

Reconciliation of Examination Changes
as of December 31, 1999

	<u>Per Company</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
<u>Assets</u>				
Federal income tax recoverable and interest thereon	\$ 20,728,817	\$ 0	\$ (20,728,817)	(3)
Electronic data processing equipment	1,634,677	255,599	(1,379,078)	(4)
Aggregate write-ins for other than invested assets	13,881,293	40,784,141	26,902,848	(5)
<u>Liabilities</u>				
Losses and loss adjustment expenses	335,531,650	491,380,353	<u>(155,848,703)</u>	(6)
Decrease in surplus as regards policyholders			\$ (151,053,750)	
Surplus as regards policyholders, December 31, 1999 per Company			<u>141,617,195</u>	
Surplus as regards policyholders, December 31, 1999 per Examination			<u><u>\$ (9,436,555)</u></u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bond and Preferred Stocks

Due to the increase in interest rates during 1999, the statement value of the Company's bond and preferred stock portfolio is greater than the market value by \$11 million as of December 31, 1999. The decrease in market value represents deterioration in the market value from the 1998 portfolio of \$23 million.

(2) Other Invested Assets

Included in the above asset account as of September 30, 2000 (See Addendum) is a \$29.9 million note receivable (Camfex Note) secured by a second deed of trust on property previously owned by the Company prior to a sale and leaseback in 1984. The previous examination of the Company nonadmitted this note due to insufficient collateral. As a result, the Company wrote off the note in December 1997.

Based on a further review of the note and the underlying collateral during the course of this examination, the note is current as to principal and interest and appears to be adequately collateralized. As a result, the Company obtained approval from the California Department of Insurance (CDI) to admit this note in its September 30, 2000 Quarterly Financial Statement.

In December 2000, the Company filed an application with the CDI seeking approval to sell the note to its immediate parent company, Fremont Indemnity Company (FIC) in exchange for \$29.9 million. Pursuant to California Insurance Code Section 1142, the CDI permitted FIC to reflect the note as an admitted asset for a period not to exceed five years from December 31, 2000. The approval provides that the CDI may review the appropriateness of allowing FIC to carry the note as an admitted asset in the future. The approval also stipulates that the carrying value (statement value) of the note cannot exceed the current appraised value of the underlying property.

(3) Federal Income Tax Recoverable and Interest Thereon

The Company established a \$20.7 million federal income tax recoverable at year-end 1999. A review of the recoverable disclosed that it was based upon the expectation of future income and the ability to apply net operating loss (NOL) carryforwards, which are not admissible under Statutory Accounting Principles. As of March 31, 2000, the Company reported federal income tax recoverable has increased by \$7.1 million to \$27.8 million. It is recommended that the Company discontinue reporting federal income tax recoverables based on NOL carryforwards.

(4) Electronic Data Processing Equipment

The captioned asset was decreased \$1.4 million due to the non admittance of application software costs incurred by the Company, which were capitalized and included in this asset. Application software is not admissible in accordance with California Insurance Code Section 1194.95.

(5) Aggregate Write-ins for Other Than Invested Assets

The captioned asset was increased by the examination in the amount of \$26.9 million and represents the net premiums paid to Reliance Insurance Company (Reliance) less loss recoverables received in conjunction with a reinsurance treaty, which was rescinded. An agreement was reached between Reliance and the Company to rescind the treaty on February 28, 2000. The Company received the net settlement from Reliance on March 29, 2000.

(6) Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI), under California Insurance Code Section 733(g), retained the actuarial firm of AMI Risk Consultants, Inc. (AMI) for the purposes of assisting this examination in determining the adequacy of the Company's loss and loss adjustment expense (LAE) reserves as of December 31, 1999. The conclusion of this reserve analysis indicated that the Company had significant loss and loss adjustment expense reserve deficiencies of \$155.8 million,

despite the fact that the Company had received unqualified actuarial opinions for all of the years under examination.

The Company engaged its independent public accountants to conduct a loss and LAE reserve analysis as of December 31, 1999. The conclusion of this reserve analysis confirmed the CDI's independent reserve analysis.

Combined Reserves: The following is a summary of the direct and net reserves as of December 31, 1999, per Company and per examination, for all the companies included in the Intercompany Pooling Agreement (combined):

Description	Direct Reserves - Combined (000 Omitted)			Net Reserves - Combined (000 Omitted)		
	Per Company	Per Examination	Deficiency	Per Company	Per Examination	Deficiency
Workers' Compensation						
Loss and ALAE Reserves	\$ 2,214,189	\$ 2,630,419	\$ (416,230)	\$ 1,357,105	\$ 1,893,185	\$ (536,080)
ULAE Reserves	55,238	188,099	(132,861)	53,860	188,099	(134,239)
Totals	2,269,427	2,818,518	(549,091)	1,410,965	2,081,284	(670,319)
All other Lines						
Loss and ALAE Reserves	296,495	296,495	0	7,536	7,536	0
ULAE Reserves	2,956	2,956	0	1,132	1,132	0
Totals	299,451	299,451	0	8,668	8,668	0
All Lines of Business						
Loss and ALAE Reserves	2,510,684	2,926,914	(416,230)	1,364,641	1,900,721	(536,080)
ULAE Reserves	58,194	191,055	(132,861)	54,992	189,231	(134,239)
Totals - All Lines of Business	\$ 2,568,878	\$ 3,117,969	\$ (549,091)	\$ 1,419,633	\$ 2,089,952	\$ (670,319)

As noted in the schedule, the combined reserves on a direct and net basis for all companies in the pool were deficient by \$549.1 million and \$670.3 million, respectively.

Post-Pooled Reserves

The following is a summary of the direct and net reserves as of December 31, 1999, per Company and per examination, after applying the Company's intercompany pooling percentage of 23.25% to the combined reserves:

Description	Direct Reserves - Post-Pooled (000 Omitted)			Net Reserves - Post-Pooled (000 Omitted)		
	Per Company	Per Examination	Deficiency	Per Company	Per Examination	Deficiency
Workers' Compensation						
Loss and ALAE Reserves	\$ 514,799	\$ 611,572	\$ (96,773)	\$ 315,527	\$ 440,166	\$ (124,639)
ULAE Reserves	12,843	43,733	(30,890)	12,523	43,733	(31,210)
Totals	527,642	655,305	(127,663)	328,050	483,899	(155,849)
All other Lines						
Loss and ALAE Reserves	127,641	127,641	0	6,350	6,350	0
ULAE Reserves	1,556	1,556	0	1,132	1,132	0
Totals	129,197	129,197	0	7,482	7,482	0
All Lines of Business						
Loss and ALAE Reserves	642,440	739,213	(96,773)	321,877	446,516	(124,639)
ULAE Reserves	14,399	45,289	(30,890)	13,655	44,865	(31,210)
Totals - All Lines of Business	\$ 656,839	\$ 784,502	\$ (127,663)	\$ 335,532	\$ 491,381	\$ (155,849)

As noted in the schedule, the Company's reserves on a direct and net basis, after pooling, were deficient by \$127.7 million and \$155.8 million, respectively.

Significant factors having an impact on the evaluation of the reserves included the following.

Reallocation of Case Reserves: The Company established a practice of reallocating case reserves to bulk and incurred but not reported (IBNR) reserves in the preparation of its Annual Statement, Schedule P. The adjustments are not supported by actuarial calculations and are not recognized by the Company's consulting actuaries. The purpose of these adjustments, according to the Company, was to avoid recording a negative IBNR. As a result of the reallocation of case reserves to IBNR, the reported case incurred developments, which are reported in the Company's financial statements, are distorted. The distortion of the reported case incurred developments directly impacts loss and LAE reserve estimates when using Schedule P data as reported in the Company's Annual Statement.

This procedure was evidenced during all years through 1998 (Company discontinued the practice in 1999).

Additionally, the Company reallocated case and IBNR reserves by accident year in the preparation of Schedule P. This practice further distorted the developments reported in the Annual Statements. Reported case reserves should not be reallocated to bulk and IBNR and/or to different accident years. It is recommended that the Company discontinue the practice of reallocating case and IBNR reserves.

Mergers and Acquisitions: As previously noted, there were a number of acquisitions and mergers during the period covered by this examination. As a result, historical loss and LAE experience may differ significantly between the companies acquired and that of the Company's. This may have a material impact on the actuarial loss and LAE reserve projections.

Workers' Compensation Deposits: Based upon the examination increases to loss and LAE reserves, the Company's workers' compensation deposit may be insufficient, pursuant to the California Insurance Code Section 11690. It is recommended that the Company recalculate its workers' compensation deposit requirements and fund any deficiencies.

(7) Aggregate Write-ins for Liabilities

As noted in the Addendum included in this examination report, the California Department of Insurance allowed the Company to discount (non-tabular) its 1999 and prior accident year workers' compensation loss and allocated loss adjustment expense reserves in its September 30, 2000 financial statements. The Company discounted its reserves by \$54.6 million and reported it as a contra-liability. In addition, the Company established a special surplus funds account in the same amount.

(8) Gross Paid-in and Contributed Surplus and Unassigned Funds

As noted previously in this report, the reallocation and distribution of surplus accounts between gross paid-in and contributed surplus and unassigned funds due to the Intercompany Pooling Agreement as well as mergers during the examination period resulted in significant changes to the distribution of the surplus of each company in the group. For purposes of this examination report, gross paid-in and contributed surplus and unassigned funds were restated to correctly account for the reinsurance pooling agreement and the mergers.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Summary of Significant Findings (Page 2): As a result of this examination, surplus as regards policyholders as of December 31, 1999 has been reduced by \$151.1 million to a deficit of \$(9.4) million. The reduction in surplus was primarily due to increases in the losses and loss adjustment expense reserves.

After applying the provisions of the permitted accounting practice (loss and allocated loss adjustment expense reserve discounting) and including all other examination adjustments, the Company reported surplus as regards policyholders of \$97.9 million as of September 30, 2000.

Gross Paid-in and Contributed Surplus and Unassigned Funds (Page 10): It is recommended that the Company restate its gross paid-in and contributed surplus and unassigned funds to conform with Statutory Accounting Principles and that it properly account for all future reinsurance pooling surplus adjustments and mergers.

Management Agreements – Tax Sharing Agreement (Page 16): The Company's tax sharing agreement does not appear to be fair and reasonable to the insurance companies and appears to be in violation of California Insurance Code (CIC) Section 1215.5(a)(1). It is recommended that the

Company amend the terms of the tax sharing agreement so that its tax position, after consolidation, is not inferior to what it would have been had it filed on a stand-alone basis and submit the agreement to the California Department of Insurance (CDI) for approval.

Corporate Records (Page 17): It is recommended that the Company comply with CIC Section 735.

Reinsurance Ceded - Unicover Pool (Page 20): Although the rescission of this treaty was included in the GAAP consolidated financial statements of Fremont General Corporation, it was not reflected in the Company's year end 1999 Annual Statement.

Losses and Loss Adjustment Expenses (Page 27): It is recommended that the Company discontinue the practice of reallocating case and IBNR reserves in the preparation of its financial statements.

In addition, it is recommended that the Company recalculate its workers' compensation deposit requirements and fund any deficiencies.

Previous Report of Examination

Due to the change in ownership of the Company, the previous examination comments are no longer applicable.

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

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ADDENDUM – Letter Agreement of Regulatory Oversight